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IN THE

Supreme Court of the United States

October Term, 1973.

No. 73-1409

JOHN J. WASNOWIC and KEYSTONE TRADERS, INC.,
Petitioners,

v.

CHICAGO BOARD OF TRADE,
CHICAGO MERCANTILE EXCHANGE,
Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

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No.

JOHN J. WASNOWIC AND
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Petitioners,

v.

CHICAGO BOARD OF TRADE, CHICAGO
MERCANTILE EXCHANGE,
Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

Petitioners, Plaintiffs in the proceedings below, respectfully pray that a writ of certiorari issue to review the judgment of the Court of Appeals entered on December 21, 1973.

OPINIONS BELOW.

The Court of Appeals affirmed the District Court below without opinion. The judgment Order to this effect is reprinted in the Appendix, *infra*, pp. A1-A2.

Three memorandum opinions were issued by the District Court. The first unreported opinion denied Respondents' Motion to dismiss and is reprinted in the Appendix, *infra*, pp. A3-A9. The second opinion, reported at 352 F. Supp. 1066 (M. D. Pa. 1972), vacated the earlier Order and granted Respondents' Motion to Dismiss. It appears in the Appendix, *infra*, pp. A10-A19. The third opinion, unreported, denied Petitioners' Motion to vacate the Court's prior order and amend their Complaint, and is reprinted in the Appendix, *infra*, pp. A20-A26.

JURISDICTION.

The judgment of the court of appeals was entered on December 21, 1973. The jurisdiction of this Court is invoked pursuant to 28 U. S. C. § 1254(1).

STATUTES INVOLVED.

Section 77b(1) of the Securities Act of 1933, 15 U. S. C. § 77b(1), 48 Stat. 74 (1933), as amended, 48 Stat. 905, 908 (1934), provides:

> "The term 'security' means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as 'security', or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing."

Section 78c(10) of the Securities Exchange Act of 1934, 15 U. S. C. § 78c(10), 48 Stat. 882 (1934) provides:

> "The term 'security' means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, or in general, any instrument commonly known as a 'security'; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's

acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited."

Section 78aa of the Securities Exchange Act of 1934, 15 U. S. C. § 78aa, 48 Stat. 902 (1934) provides:

"The district courts of the United States, and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enforce any liability or duty created by this chapter or rules and regulations thereunder, or to enjoin any violation of such chapter or rules and regulations, may be brought in any such district or in the district wherein the defendant is found or is an inhabitant or transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 225 and 347 of Title 28. No costs shall be assessed for or against the Commission in any proceeding under this chapter brought by or against it in the Supreme Court or such other courts."

QUESTIONS PRESENTED.

This action was brought by Petitioners as investors in discretionary commodity trading accounts to recover damages for alleged violations of the Securities Act of 1933, the Securities Exchange Act of 1934 and the Commodity Exchange Act. Extraterritorial service of process was effected upon the defendants pursuant to Section 27 of the 1934 Act, 15 U. S. C. § 78aa. Defendants moved to dismiss the action for invalid service of process on the grounds that the discretionary commodity trading account as described in the Complaint did not constitute a security as defined in the 1933 and 1934 Acts, and thus extraterritorial service of process was improper. The District Court eventually granted this motion and denied Petitioners leave to amend their complaint.

The important question presented for review is as follows:

> Does a discretionary commodity trading account, in which all investment decisions are made solely by the commodity broker, constitute an investment contract, and hence a security, for purposes of the federal securities laws which this Court has decreed must be interpreted liberally not technically and restrictively?

Additionally, a subsidiary question is presented:

> Would the amendments to the complaint proposed by Plaintiffs have added the element of "commonality" to the transaction in question so as to bring it within the definition of an investment contract as that term is construed in *Milnarik v. M-S Commodities, Inc.*, 457 F. 2d 274 (7th Cir. 1972)? If so, did the Courts below err in refusing Petitioners leave to amend their complaint?

STATEMENT OF THE CASE.

This case was instituted as a class action with the filing of a complaint on August 25, 1969 by plaintiffs John J. Wasnowic and Keystone Traders, Inc. (Keystone). Named as defendants were J. Samuel Sicherman, trading as J. Samuel Sicherman & Co., the Chicago Board of Trade and the Chicago Mercantile Exchange. It was alleged that Sicherman,[1] in his dealings with plaintiffs, violated certain sections of the Securities Act of 1933, 15 U. S. C. § 77 *et seq.*, the Securities Exchange Act of 1934, 15 U. S. C. § 78 *et seq.*, and the Commodity Exchange Act, 7 U. S. C. § 1 *et seq.* The Exchanges were accused of aiding and abetting Sicherman in his violations of the Securities laws. Subsequent to the filing of the complaint, Commodity Fund, Inc. was added as an additional party-plaintiff.

The Complaint alleged that discretionary commodity accounts were opened by the plaintiffs with Sicherman. Sicherman then proceeded to invest the funds of plaintiffs in the commodities market. All investment decisions were made solely by Sicherman, as agreed by the parties. Subsequently, on April 1, 1969, a petition in bankruptcy was filed against Sicherman in the Middle District of Pennsylvania, and on May 6, 1969 he was adjudicated a bankrupt. At that time Sicherman held funds in the accounts of plaintiffs Wasnowic and Keystone, respectively, of over $42,000 and $521,000.

Plaintiffs alleged that during the period of January 1, 1960 to April 1, 1968 Sicherman violated the Commodity Exchange Act by neglecting to keep sufficient funds in his customers' segregated accounts to pay all equities and credits due them and by failing to keep proper records and

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1. References to Sicherman will hereafter include both Mr. Sicherman and his firm.

accountings of customer margin funds. They also alleged that Sicherman violated the Securities Act of 1933 and the Securities Exchange Act of 1934 by converting to his own use money and securities which properly belonged to his customers and by concealing this fraudulent misuse of funds through false and misleading statements.

The Exchanges were charged with aiding and abetting the wrongdoing of Sicherman in the following ways: by failing to enforce their rules requiring annual and semi-annual financial statements from its members, and accepting instead the false statements of Sicherman; by failing to audit the Sicherman books; by accepting an audit of the Sicherman records by the Agricultural Authority as adequate to protect the investing public; by failing to regulate the business activity of its member Sicherman; and by failing to expel and discipline Sicherman for the illegal activities carried on by him for many years. The District Court concluded in its Memorandum of December 31, 1970 that the allegations of aiding and abetting were sufficient to state a cause of action against the Exchanges (App., pp. A6-A7).

Because the defendant Exchanges could not be physically served within the Middle District of Pennsylvania where the suit was brought, plaintiffs sought, and were granted, a special order from the District Court authorizing service of process upon the Exchanges at their respective headquarters in Chicago pursuant to Section 27 of the 1934 Act, 15 U. S. C. § 78aa. Service of process was subsequently accepted by both Exchanges.

Motions to dismiss and to quash service of process were made separately by the Exchanges on the ground, *inter alia*, that the complaint did not state a cause of action under the 1934 Act for the reason that discretionary commodities trading accounts are not "securities" under the Act, and therefore extraterritorial service permitted by the

1934 Act is not afforded to plaintiffs herein. The District Court denied these motions, reasoning that the discretionary commodity accounts as described by plaintiffs constituted "investment contracts" and thus securities under the Act. Subsequently, the Exchanges urged the Court to reconsider its ruling, arguing that the complaint failed to allege facts sufficient to support the claim that the Exchanges had "aided or abetted" Sicherman. The Court refused to reconsider its prior ruling.

In July, 1972 the Exchanges renewed their motions to dismiss for improper service of process, in reliance on a recent decision, *Milnarik v. M-S Commodities, Inc.*, 457 F. 2d 274 (7th Cir. 1972), in which a discretionary commodity account was judged not to constitute a security under the 1933 or 1934 Acts because the element of a "common enterprise entered into for mutual profit" was not present. In their response to this motion, plaintiffs asserted that the element of commonality was present in the pooling of investor funds in Keystone, and informally requested leave to amend their complaint by adding the corporate charter of Keystone to clarify its operation as an "open end" investment company.

Persuaded by the reasoning of *Milnarik,* the Court granted the motion to dismiss. While not expressly granting plaintiffs' request to amend, the opinion of the Court nevertheless considered the proposed amendment and held that the amendment would add an element of commonality only to the relationship between Keystone and its shareholders but would not change the nature of the account between Keystone and Sicherman. Therefore, the commonality element would still not be satisfied.

Following the dismissal, plaintiffs moved the Court on December 13, 1972 for leave to amend the complaint, and to set aside the dismissal. Plaintiffs' proposed amended

complaint set forth the relevant portion of the Keystone charter, alleged that Sicherman had promoted the sale of Keystone stock to potential investors, alleged that Sicherman had represented to plaintiffs that the Keystone funds would be invested in commodity futures under his direction, and alleged that Sicherman misappropriated the Keystone funds after they were deposited with his firm. Reasoning that these amendments affected only the agreement between Keystone and its shareholders, and that the "investment contract" relied on by plaintiffs in the complaint was between Keystone and Sicherman, the Court concluded that the amendments would not cure the jurisdictional defects in the complaint and the motion to amend was denied.

Plaintiffs appealed the dismissal of the action by the District Court, and also filed a motion with the Third Circuit Court of Appeals for leave to file an amended complaint under 28 U. S. C. § 1653. In essence, the proposed amendments alleged that Sicherman had organized plaintiffs Keystone and Commodity Fund, Inc.; that he had managed the funds invested in these corporations; that he had participated in the sale of Keystone stock to the public; and that he had made various material misrepresentations concerning the stock to actual and potential investors. The Court of Appeals affirmed the decision of the District Court without opinion, (App., p. A2), apparently denying leave to amend under 28 U. S. C. § 1653.

REASONS FOR GRANTING THE WRIT.

Introduction.

The opinion of the District Court below reflects one of a number of conflicting interpretations of the meaning of the term "investment contract" as used in the federal securities laws and as applied to discretionary commodity trading accounts. While the Supreme Court has never passed directly upon the issue of whether a discretionary commodity trading account is an "investment contract," the meaning of that term has been extensively discussed in *Securities & Exchange Commission v. W. J. Howey Co.*, 328 U. S. 293, 66 S. Ct. 1100 (1946). The test of "investment contract" as set forth in that opinion has been widely utilized by the federal courts in subsequent cases involving a myriad of factual circumstances.

As set forth in more detail, *infra*, the District Court below construed one of the elements of the *Howey* test, the requirement that the investor be engaged in a "common enterprise," as necessitating a "pooling" or "commingling" of investor capital. It is submitted that such a construction of the *Howey* test is erroneous and has serious implications for the administration and enforcement of the securities laws.

The District Court's interpretation of the "common enterprise" element, and the acquiescence in it by the Third Circuit, is based on an opinion of the Seventh Circuit in *Milnarik v. M-S Commodities, Inc.*, 457 F. 2d 274 (7th Cir. 1972). This interpretation is in direct conflict with other federal cases applying *Howey* to discretionary commodity trading accounts, including two cases arising out of the Eighth and Tenth Circuits. *Commercial Iron and Metal Co. v. Bache & Co.*, 478 F. 2d 39 (10th Cir. 1973); *Booth v. Peavey Company Commodity Services*, 430 F. 2d 132 (8th Cir., 1970). This conflict among the Circuits over

the meaning of the "common enterprise" element of the *Howey* test has resulted in a pervasive uncertainty as to the applicability of the federal securities laws to discretionary commodity trading, and should be resolved by this Court.

I. The Courts Below Have Erroneously Interpreted the Meaning of the Term "Common Enterprise" as Used in the Test of an Investment Contract Set Forth by the Supreme Court in Securities and Exchange Commission v. W. J. Howey Co., 328 U. S. 293 (1946).

In granting respondents' motion to dismiss, the District Court decided that the discretionary commodity account established between petitioners and Sicherman as described in the original complaint did not constitute a security within Section 2(1) of the Securities Act of 1933, 15 U. S. C. § 77b(1) and Section 3(a) (10) of the Securities Exchange Act of 1934, 15 U. S. C. § 78c(a) (10). Consequently, the extraterritorial service of process upon respondents was found to have no validity under either of these securities laws and the case was dismissed for improper service of process. Petitioners contend that the investment relationship between themselves and Sicherman, as described in the complaint, did constitute a security and that extraterritorial service of process was therefore proper.

The term "security" under both the 1933 and 1934 Acts is defined so as to include the term "investment contract" in its definition.[2] While the term "investment contract" is defined in neither of these Acts, this Court has several times in the past had occasion to expound on the

2. These definitions are set forth verbatim in the "Statutes Involved" section of this Petition. They are virtually identical and will be treated as interchangeable for purposes of this Petition. See *Tcherepnin v. Knight*, 389 U. S. 332 (1967).

meaning to be given this term. *Securities and Exchange Commission v. C. M. Joiner Leasing Corporation,* 320 U. S. 344, 64 S. Ct. 120 (1943); *Securities and Exchange Commission v. W. J. Howey Co.,* 328 U. S. 293, 66 S. Ct. 1100 (1946); *Tcherepnin v. Knight,* 389 U. S. 332, 88 S. Ct. 548 (1967). The principles laid down in these cases clearly indicate that a discretionary commodity account constitutes an investment contract.

In *Howey,* this Court discussed at length the definition of an "investment contract". That case dealt with the sale of identifiable parcels of land in a citrus grove development. The parcels were conveyed to the purchaser under a warranty deed, each parcel containing a number of growing citrus fruit trees. Each purchaser was also offered a "service contract" under which the seller, through its own service company, would obtain a leasehold interest in the land and "full and complete" possession of the acreage. For a specified fee, plus the cost of labor and harvesting and marketing of the crops, the service company would harvest and sell the fruit and account to each purchaser for profits made on his own trees. Each purchaser was free to contract with the defendant company or any other company for the servicing of his parcel. The Court concluded that this arrangement constituted the offering of an "investment contract" under the 1933 Act.

As set forth by the *Howey* court, the test of an investment contract is "whether the scheme involves an investment of money in a common enterprise with profits to come solely from the effort of others". 328 U. S. at 301, 66 S. Ct. at 1104. The District Court below held that to satisfy the "common enterprise" requirement there must be more than one investor and a "pooling" or "commingling" of investor funds. However, this theory finds no basis in *Howey.* See *Marshall v. Lamson Bros., Inc.,* 368 F. Supp. 486 (S. D. Iowa, 1974).

The stipulated facts upon which *Howey* rests reveal that there was no sale of a right to share with others in the profits of land held in common with the defendant companies or others. In the case of each grove, as in the yield of the fruit, the cost of the care and the proceeds of the fruit were definitely and distinctly accounted for with respect to the specific property owned by the individual. *Securities and Exchange Commission v. W. J. Howey Co.*, 151 F. 2d 714, 715-16 (5th Cir. 1945). In this respect, the *Howey* arrangement was similar to that in which a commodity broker simultaneously supervises the accounts of a number of individual clients. Furthermore, the *Howey* purchasers were permitted to enter into service contracts with companies other than the seller's service company and the existence of this option implies that the fruit of each individual parcel was cared for, cultivated and marketed without any pooling of either costs or profits.

> "Thus all the elements of a profit seeking business venture are present here. The investors provide the capital and share in the earnings and profits; the promoters manage, control and operate the enterprise. It follows that the arrangements whereby the investors' interests are made manifest involve investment contracts, regardless of the legal terminology in which such contracts are clothed." *Securities and Exchange Commission v. W. J. Howey Co.*, 328 U. S. 293, 300, 66 S. Ct. 1100, 1104 (1946).

An examination of the authorities relied upon by the *Howey* Court further supports the position that a "pooling of funds" was not essential to the Court's definition of "common enterprise." In discussing the development of the meaning of "investment contract" in state courts, the Court cited *State v. Gopher Tire and Rubber Co.*, 146 Minn.

52, 177 N. W. 937 (1920) in which there was admittedly a pooling of investor funds. However, an inspection of that opinion reveals that nowhere did the Minnesota court require "pooling" as a necessary element of an investment contract; on the contrary, all that state court required was "a placing of capital or laying out of money in a way intended to secure income or profit from its employment." *Id.*, at 56, 177 N. W. at 938. *See State v. Evans*, 154 Minn. 95, 191 N. W. 425 (1922). Similarly, in *Prohaska v. Hemmer-Miller Development Co.*, 256 Ill. App. 331 (1930), the purchase of farm land for a fractional down payment with the remainder of the purchase price to come from the proceeds of crops grown on the land by the promoter was held to be an investment contract despite the absence of any commingling of crops and the distinct separate nature of the parcels of land. In addition, there were no pooling arrangements in *People v. White*, 124 Cal. App. 548, 12 P. 2d 1078 (1932) and *Securities and Exchange Commission v. Payne*, 35 F. Supp. 873 (S. D. N. Y. 1940).

If any doubt remained after *Howey* that pooling or commingling of investor capital was not a necessary element of a "common enterprise," that doubt was laid to rest in *Blackwell v. Bentsen*, 203 F. 2d 690 (5th Cir. 1953), *certiorari dismissed* 347 U. S. 925 (1954). There the facts of the case were almost identical to *Howey*, with a few exceptions: the tracts of land sold were considerably larger (20 to 40 acres as opposed to an average lot size of 1.33 acres in *Howey*), more definitely identified and separated, and each owner was permitted to enter his land to harvest and sell his own fruit. As in *Howey*, the proceeds to each owner were based on the sale of his own fruit, and no pooling took place. The Court in *Blackwell* emphasizes that commingling of funds is not the essence of a "common enterprise."

> "Instead of a stock certificate evidencing a share in a common ownership of capital assets, these purchasers receive a deed *evidencing an ownership in severalty.* But the paramount emphasis is upon the income to accrue, which is the chief, if not the sole, attraction to the purchaser." 203 F. 2d at 693 (Emphasis supplied)

What, then, is the meaning of "common enterprise?" In *Securities and Exchange Commission v. Glenn W. Turner Enterprises, Inc.*, 474 F. 2d 476, 482 (9th Cir. 1973) the court defined a common enterprise as "one in which the fortunes of the investor are interwoven with and dependent upon the efforts and success of those seeking the investment or of third parties." Under this interpretation of *Howey*, the common enterprise can be between *either* a group of investors or *a single investor and the promoter himself*, so long as the fortunes of one are dependent upon the efforts of the other. Thus, in *Howey* and *Blackwell* each investor was entirely independent of the other investors; but for those who chose the promoter's service contract, their degree of success was entirely dependent upon the skill and amount of effort shown by the promoter. Thus was established a common enterprise.

A close examination of *Howey* and *Blackwell* reveal that interweaving of fortunes of the investor and the promoter does not even require that the profits of the promoter be a direct function of the profits of the investor, i.e., calculated as a percentage of the investor's profits. In *Howey* the promoter received a fixed fee plus the costs of labor and materials for his services. In *Blackwell*, the promoter received 5% of the proceeds of sale, *not the profits.* Thus, in either case the investor could actually sustain a loss and the promoter would nonetheless receive some income. There is little, if any, difference in principle between such

an arrangement and a discretionary commodity account in which the broker bases his fee on a percentage of the absolute amount of the purchase or sale irrespective of whether it resulted in a profit or loss. The element of "common enterprise" is nevertheless present; the investor supplies the capital, the broker supplies the expertise, and the fortunes of both lie solely in the hands of the broker.

In light of the foregoing analysis, it would appear that the District Court and the Third Circuit have erroneously construed and applied the *Howey* test in the instant case. The District Court reasoned that the commonality element of *Howey* was not present because there was no commingling or pooling of investor funds, nor a consequent proportionate sharing of profits among investors. In its Memorandum of November 17, 1972 the Court stated:

> "Thus it is clear that plaintiffs did not enter into discretionary trading agreements with Sicherman with the understanding that their customers would *share ratably in the profits.* Without the presence of this element of the *Howey* test, plaintiffs' individual discretionary trading account with Sicherman cannot be considered as a security within the meaning of the Securities laws." See App., p. A15, (Emphasis supplied.)

As the above quotation clearly indicates, the District Court failed even to consider the possibility that the relationship between plaintiffs as individual investors and Sicherman could suffice to satisfy the "common enterprise" element of *Howey.* To correct this erroneous interpretation of a decision of this Supreme Court, and the subsequent acquiescence of the Third Circuit, this Court should grant certiorari.

II. There Is a Conflict Among the Circuits on the Issue of Whether a Discretionary Commodity Account Constitutes a Security for Purposes of the Federal Securities Laws.

Until recently, the lower federal courts had almost universally applied the *Howey* test of investment contract in such a way as to emphasize its "reliance" aspect (reliance for profits solely on the skill or expertise of another) and had generally ignored the "commonality" element when dealing with discretionary commodity accounts. The reason for this attitude of the courts is necessarily attributable either to their belief that the "common enterprise" element of the *Howey* test is mere surplusage, or that the interpretation of "common enterprise" set forth in the preceeding section is essentially correct. In either case, the requirement of the Courts below that there be a "pooling or commingling" of investor capital and a ratable sharing of profits prior to a finding of commonality is distinctly at odds with the approach taken by most federal courts.

Admittedly, the traditional commodity account was universally held not to constitute an investment contract, for the obvious reason that trading discretion is lodged either entirely with the client or jointly with the client and broker and thus the "reliance" element of the *Howey* test is not satisfied. *Sinva, Inc. v. Merrill, Lynch, Pierce, Fenner and Smith, Inc.*, 253 F. Supp. 359 (S. D. N. Y. 1966). However, many cases following *Howey* have held, in conflict with the decisions of the District Court and Third Circuit herein, expressly or impliedly, that a discretionary commodity account constituted an investment contract under the 1933 and 1934 Acts. *Commercial Iron and Metal Co. v. Bache & Co.*, 478 F. 2d 39 (10th Cir. 1973); *Booth v. Peavey Company Commodity Services*, 430 F. 2d 132

(8th Cir. 1970); *Marshall v. Lamson Bros. & Co.*, 368 F. Supp. 486 (S. D. Iowa 1974); *Johnson v. Arthur Espey, Shearson, Hammill & Co.*, 341 F. Supp. 764 (S. D. N. Y. 1972); *Anderson v. Francis I. duPont & Co.*, 291 F. Supp. 705 (D. Minn. 1968); *Berman v. Orimex Trading, Inc.*, 291 F. Supp. 701 (S. D. N. Y. 1968); *Mahue v. Reynolds & Co.*, 282 F. Supp. 423 (S. D. N. Y. 1967).

In *Commercial Iron & Metal Co., supra,* the Tenth Circuit was faced with the question of whether a discretionary commodity account constituted a security in deciding whether summary judgment had been properly granted below. The Court concluded that there was a factual question concerning the reliance of the customer on the expertise of the broker and pointedly ignored the issue of whether there was any "pooling or commingling" of investor funds in a common enterprise.

> "In our case the issue is whether the investment scheme of Louis constitutes an investment contract. If Louis's statements to Duman, as alleged in appellant's complaint, implied that all investment decisions would be made by Louis, while promising Commercial large profits, we might have a discretionary account constituting an investment contract even though the copper contracts which lay behind the arrangements are not themselves securities." 478 F. 2d at 42.

The fact that this Court cited *Mahue* and *Berman, supra,* as support for its position conclusively demonstrates that in the Tenth Circuit a discretionary commodity account will be viewed as possessing all the elements necessary to satisfy the *Howey* test of an investment contract without inquiry into any "pooling or commingling" of investor funds.

In *Booth v. Peavey Company Commodity Services, supra,* the Eighth Circuit stated categorically that allegations that a defendant "churned" a discretionary commodity account states a cause of action under the Commodity Exchange Act, the Securities Act of 1933, and the Securities Exchange Act of 1934. The facts in *Booth* clearly indicate that only a single discretionary commodity account was involved and no "pooling or commingling" of investor funds took place. Since a cause of action under both the 1933 and 1934 Acts requires the involvement of a "security" as defined by those Acts, the conclusion is inescapable that in the Eighth Circuit a single discretionary commodity account constitutes a security. Again, this Court cited *Mahue, Berman,* and *Anderson* as support for its conclusion.

A very recent District Court decision from the Southern District of Iowa, *Marshall v. Lamson Bros. & Co.,* 368 F. Supp. 486 (S. D. Iowa 1974), indicates that Court's opinion that *Booth* accurately states the position of the Eighth Circuit on this question. However, feeling that the *Booth* court was not called upon to discuss extensively the *Howey* meaning of "common enterprise," the Court cogently discussed the facts and background of *Howey* and concluded that a "common enterprise" did *not* require any "pooling of funds." In effect, the *Marshall* Court was faced with the exact issue petitioners now seek this Court to decide. *Marshall* considered the conflicting interpretations of the *Howey* test represented by *Milnarik* and the instant case in the Courts below on one hand, and the *Berman, Mahue,* and *Booth* line of cases on the other hand. Concluding that the facts in *Howey* and subsequent administrative interpretations by the S. E. C. demonstrated that the meaning given to "common enterprise" by the *Milnarik* court was overly restrictive, *Marshall* held that

a discretionary commodity account does, indeed, constitute an investment contract even in the absence of a "pooling" of investor funds.

The *Marshall* case is important in several ways. First, it is the only decision other than *Milnarik*, up to the present time which has analyzed this problem of the meaning of "common enterprise," and, in a well-reasoned opinion, concluded that the *Milnarik* standard simply cannot be reconciled with the facts of *Howey*. Secondly, *Marshall* points out explicitly the existence of what promises to be a continually widening conflict among the Circuits as more and more dissatisfied commodity investors seek relief under the federal securities laws. It frankly acknowledges the fact that the Supreme Court has left in a judicial limbo the meaning of the term "common enerprise" as applied to the test of an investment contract, and, that the lower courts, left to their own devices, have set out in at least two widely divergent directions in supplying this meaning. In addition to *Commercial Iron and Metal Co.* and *Booth*, a number of District Court opinions have reached the conclusion that a discretionary commodity account constitutes an investment contract irrespective of any "pooling or commingling" of investor capital. *Johnson v. Arthur Espey, Shearson, Hammill & Co.*, 341 F. Supp. 764 (S. D. N. Y. 1972); *Anderson v. Francis I. duPont & Co.*, 291 F. Supp. 705 (D. Minn. 1968); *Berman v. Orimex Trading, Inc.*, 291 F. Supp. 701 (S. D. N. Y. 1968); *Mahue v. Reynolds & Co.*, 282 F. Supp. 423 (S. D. N. Y. 1967). Two of these cases, *Mahue* and *Orimex*, were expressly relied upon by the District Court below when it originally denied respondents' motion to dismiss. In *Mahue*, the Court considered the contention of the defendants that the absence of "pooling or commingling" of funds in a discretionary commodity account precluded a finding that such an

account could constitute an investment contract under *Howey*. Relying on the fact that the *Howey* court reversed the decision of the Court of Appeals which refused to find a security because of the absence of a common enterprise, the *Mahue* court concluded that a single discretionary commodity account is a security even in the absence of a "pooling or commingling" of investor funds. 282 F. Supp. at 429. *Orimex* reached a similar conclusion on the basis of the reasoning of the *Mahue* court. 291 F. Supp. at 702. The fact that both *Commercial Iron and Metal Co.* and *Booth* cited these two lower court opinions as support for their respective decisions strongly indicates that the interpretation of *Howey* in the Eighth and Tenth Circuits conflicts fundamentally with that of the Third Circuit in the instant case and the Seventh Circuit in *Milnarik v. M-S Commodities, Inc.*, 457 F. 2d 274 (7th Cir. 1972), as expanded below.

In addition to the cases concerned directly with discretionary commodity accounts, other recent decisions involving other types of investments support the conclusion that "pooling or commingling" of funds is not the essence of a common enterprise as used in the *Howey* test. *Hughes v. Dempsey-Tegeler & Co., Inc.*, CCH Fed. Sec. L. Rep. ¶ 94,133 (C. D. Cal. 1973) (subordination agreement between single customer and broker is an investment contract); *Securities and Exchange Commission v. Haffenden-Rimar International, Inc.*, 362 F. Supp. 323 (E. D. Virginia, 1973) (scotch whisky warehouse receipts are securities); *Securities and Exchange Commission v. M. A. Lundy Associates*, 362 F. Supp. 226 (D. R. I. 1973) (scotch whisky warehouse receipts are securities); *Mitzner v. Cordet International, Inc.*, 358 F. Supp. 1262 (N. D. Ill. 1973) (sale of area distributorship held to be a security). In effect, these cases indicate that "pooling or commingling" of in-

vestor capital has generally not been considered a *sine qua non* by the courts for a determination that a particular investment scheme constitutes a security. In that respect these cases add support to the view that a discretionary commodity account, where investment decisions are made solely by the broker, does constitute a security even absent any "pooling or commingling" of investor funds.

As mentioned, the District Court in the instant case was at first persuaded that the allegations of the complaint adequately supported the existence of a discretionary commodity account, and that under *Mahue* and *Orimex, supra,* such an account was an investment contract for purposes of the federal securities law (App., p. A6). However, on a renewed motion to dismiss, the Court reversed itself in light of *Milnarik v. M-S Commodities, Inc.,* 457 F. 2d 274 (7th Cir. 1972), concluding that *Mahue* and *Orimex* erroneously interpreted the *Howey* standard as set forth by the Supreme Court and that *Milnarik's* requirement of a "pooling or commingling" of investor funds comported more closely with that test of an investment contract (App., pp. A14-A15).

In *Milnarik,* the Court purported to apply the *Howey* test to a discretionary commodity account in determining whether it constituted an investment contract. The Court applied *Howey* without an analysis of its factual background and concluded that the element of common enterprise required some "pooling or commingling" of investor funds. Absent such pooling or commingling of investor funds, a discretionary commodity account constituted no more than an agency relationship between the broker and his customer and was thus beyond the statutory definition of a security. As noted, the Trial Court below and the Third Circuit, in its somewhat cryptic affirmance, found *Milnarik* persuasive.

It is thus clear that there is a conflict among the Circuits as to the proper application of the *Howey* test of an investment contract to a discretionary commodity account. In the Third and Seventh Circuits the state of the law appears to be that a discretionary commodity account is not an investment contract unless there is some "pooling or commingling" of investor funds. In the Eighth and Tenth Circuits such an account will be treated as an investment contract whether any pooling takes place or not, so long as the investor relies solely on the broker for his profit. This latter approach also reflect the prevailing view of the District Courts. In order to resolve this conflict over an important question in the administration and enforcement of the federal securities laws, the Court should grant certiorari.

III. Even Under the Overly-Stringent Milnarik Standard the Amendments Offered by Plaintiffs Would Have Supplied the Element of Commonality and Leave to Amend the Complaint Thus Should Have Been Granted by the Courts Below.

Petitioners are convinced that a correct interpretation of the *Howey* test must invariably lead to the conclusion that a discretionary commodity account does constitute an investment contract. In this respect, the Courts below were incorrect. However, even under the erroneous test of "common enterprise" which was set forth in *Milnarik* and accepted by the Court below, petitioners submit that the amendments offered in the District Court and to the Court of Appeals alleged sufficient pooling of investor funds by Sicherman in his capacity as a commodities broker to satisfy the *Milnarik* test. Consequently, the Courts below should have allowed the amendments to the complaint offered by Petitioners.

In its Memorandum and Order of December 15, 1972 the District Court denied plaintiffs' motion to amend their complaint on the grounds that the proffered amendments would not cure the defects in the complaint.[3] Briefly, the argument of the Court was that the "investment contracts" upon which the plaintiffs relied to establish jurisdiction were the separate commodity accounts between the plaintiffs as individual investors and Sicherman. The amendments, however, according to the court, would have done nothing more than implicate Sicherman in the organization of Keystone and the offering and sale of Keystone stock, and such amendments would in no way alter the discretionary account between Keystone and Sicherman. The relationship would still be that between a *single* investor (Keystone) and a single broker, and no "pooling or commingling" of investor funds would be alleged in *this relationship*. It is submitted that such reasoning entirely misses the thrust of plaintiffs' argument.

What plaintiffs were attempting to clarify by their proposed amendments was that Sicherman had utilized Keystone Corporation as a vehicle through which he solicited funds of individual investors for the purpose of pooling these funds and investing in the commodities market. It must be emphasized that one cannot separate the role of Sicherman as an organizer of Keystone from his role as a commodities broker, for to do so would exalt form over substance. As a broker, Sicherman needed accounts, and the larger the account the more profitable to him would be its management. In order to tap the vast reservoir of investors whose funds available for speculation are too small in isolation to compete profitably in the commodities market, Sicherman organized Keystone and touted it as a

3. The essence of these proposed amendments is set forth., *supra*, pp. 8-9.

corporation in which these small investors could combine their funds into a significant investing body, under his direction, and share ratably in its profits. In reality, if not in form, he was offering an investment contract.

Had the District Court reflected on the implications of its decision to treat Sicherman as wearing an "organizer's hat" and a "broker's hat," it might have realized the disastrous potential it had unleashed. Essentially, the Court has concluded that what a commodities broker could not do under *Howey* without establishing an investment contract, he can do now if he merely incorporates the pooled assets he has solicited prior to investing them. Surely the Court would agree that if Sicherman had approached a number of investors and persuaded them to open discretionary accounts with him with the understanding that the accounts would be pooled, the funds invested as a unit, and the profits or losses shared ratably by the participants, an investment contract would exist under *Howey*. Yet that arrangement differs from Sicherman's arrangement with the Keystone investors only in the fact that Sicherman incorporated Keystone to represent the "pool" of funds.

In discussing the proper construction to be given the term "investment contract", the Supreme Court has stated that form should be disregarded for substance and emphasis placed upon economic reality. *Securities and Exchange Commission v. W. J. Howey Co.*, 328 U. S. 293, 298 (1946). The term "embodies a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits." Id., at 299. Had the District Court actually placed emphasis on the economic reality described by plaintiffs' proposed amendments, it would have been constrained to conclude that the "pooling or commingling" of funds required by *Milnarik* was adequately alleged by these amendments.

With the defect cured, there remained no reason why the District Court should not have granted plaintiffs leave to amend. In fact, under the cases cited by the Court itself, amendment should have been permitted once it was established that the defect was cured. *John Birch Society v. NBC,* 377 F. 2d 194 (2nd Cir. 1967); *Moore v. Coats Co.,* 270 F. 2d 410 (3rd Cir. 1959). Furthermore, this Court in the past has vigorously supported the mandate of the Federal Rules of Civil Procedure that leave to amend should be freely granted where justice so requires. *Foman v. Davis,* 371 U. S. 178, 83 S. Ct. 227 (1962).

The fact that the case had been dismissed should be no bar to the amendments, since under Rule 15(a) the Court, in its discretion, may grant leave to amend even after the original complaint has been dismissed. *United Steel Workers of America, AFL-CIO v. Mesker Bros. Industries,* 457 F. 2d 91 (8th Cir. 1972); *Ballow v. General Electric Company,* 393 F. 2d 398 (1st Cir. 1968); *Negrich v. Hohn,* 379 F. 2d 213 (3rd Cir. 1967). In fact, it has been held that a complaint may be amended as of right even after the filing and granting of a motion to dismiss, since such a motion is not a "responsive pleading" within the meaning of Rule 15. *Hanraty v. Ostertag,* 470 F. 2d 1096 (10th Cir. 1972); *Nolen v. Fitzharris,* 450 F. 2d 958 (9th Cir. 1971).

It should be noted that either the District Court or the Court of Appeals could have permitted the proposed amendments to be made under 28 U. S. C. § 1653 since the defect asserted in the original complaint was jurisdictional in nature.[4] This section is to be construed liberally to permit the action to be maintained, *Cox v. Livingston,* 407 F. 2d 392 (2nd Cir. 1969); *John Birch Society v. NBC, supra,* and leave to amend is to be denied only if the amend-

4. "Defective allegations of jurisdiction may be amended, upon terms, in the trial or appellate courts."

ments would not cure the defects in the pleadings. Therefore, since plaintiffs proposed amendments would have supplied the element of "commonality" even as required by *Milnarik*, the Courts below should have permitted the amendments to be made and the trial to proceed on the merits.

CONCLUSION.

Petitioners respectfully urge that the writ issue in order to resolve a serious conflict among the Circuits and correct the erroneous interpretation of *Securities and Exchange Commission v. W. J. Howey Co.*, 328 U. S. 293, 66 S. Ct. 1100 (1946) rendered by the Courts below.

Respectfully submitted,

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Dated: March 20, 1974.

APPENDIX.

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT.

No. 73-1072.

JOHN J. WASNOWIC and KEYSTONE TRADERS, INC.,

Appellants,

v.

CHICAGO BOARD OF TRADE, CHICAGO MERCANTILE EXCHANGE,

Appellees.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE MIDDLE DISTRICT OF PENNSYLVANIA.

Submitted Under Third Circuit Rule 12(6)
on December 13, 1973.
Before FORMAN, HUNTER and GARTH, *Circuit Judges.*

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Warren, Hill, Henkelman & McMenamin
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John H. Stassen
James W. Scanlon, Sr.
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Albert H. Aston
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Attorneys for Appellees

Judgment Order.

After consideration of all the contentions raised by the appellants, it is

ADJUDGED and ORDERED that the judgment of the district court be and is hereby affirmed. See Judge Nealon's Memorandum and Order of November 17, 1972.

Costs taxed against appellants.

By the Court,

JAMES HUNTER, III,
James Hunter, III, *Circuit Judge*

Date: Dec. 21, 1973

Attest:

THOMAS F. QUINN,
Thomas F. Quinn, Clerk

District Court Memorandum.

Filed Dec. 31, 1970

This class action arises under the Securities Act of 1933, the Securities Exchange Act of 1934, the Commodities Exchange Act of 1936, and the Rules and Regulations of the Board of Trade of the City of Chicago, the Chicago Mercantile Exchange, the Commodities Exchange Commission, the Commodities Exchange Authority, and the Securities Exchange Commission. Presently before the Court for determination are motions to dismiss the plaintiffs' complaint for lack of jurisdiction and venue filed by defendants Board of Trade of the City of Chicago (hereafter Board of Trade) and Chicago Mercantile Exchange (hereafter Exchange). Supporting affidavits have been filed by all parties.

Plaintiffs were customers of J. Samuel Sicherman,[1] trading as J. Samuel Sicherman & Co. (hereafter Sicherman), a stockbroker and member of the Board of Trade and the Exchange. Plaintiffs seek to recover damages from the Board of Trade and the Exchange for aiding and abetting Sicherman in his alleged violations of the aforesaid Acts of Congress and pertinent Agency Rules and Regulations. From January, 1960, to April, 1968, Sicherman is alleged to have had insufficient funds in customers' segregated accounts to pay all amounts due his customers and to have falsely informed them of investments made on their behalf with the Board of Trade and the Exchange. $1.5 million dollars is sought in damages for the benefit of the class, which exceeds 250.

At the time of the filing of the complaint, plaintiffs secured a special order for the extraterritorial service of process of the summons and complaint pursuant to Section 27 of the Securities Exchange Act of 1934, 15 U. S. C.

1. Sicherman was adjudicated a bankrupt on May 6, 1969.

§ 78aa.[2] Defendant immediately challenged this service of process and, in addition, objected to the venue of this action in the Middle District of Pennsylvania.

I. Service of Process.

Plaintiffs contend that service of process perfected upon defendants is valid under the Securities Act of 1933 and the Securities Act of 1934 because the investment accounts they had with Sicherman were discretionary commodities accounts, a type of investment contract within the means of the term "securities" as defined in the aforesaid Acts. Securities is defined in the Securities Exchange Act of 1934, 15 U. S. C. §78c(10),[3] as follows:

> "The term 'security' means any note, stock, treasury stock, bond, debenture . . . *investment contract* . . . (Emphasis supplied.)

"The test (for an investment contract) is whether the scheme involves as investment of money in the common enterprise with profits to come solely from the efforts of others." S. E. C. v. W. J. Howey Co., 328 U. S. 293 (1946),

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2. Section 27 of the Securities Exchange Act of 1934 states as follows:

> "The district courts of the United States . . . shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions of law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder. * * * Any suit or action to enforce any liability or duty created by this chapter or rules and regulations thereunder . . . may be brought in any such district or in the district wherein the defendant is found or is an inhabitant or transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found * * *"

3. The Securities Act of 1933 contains a definition of security virtually identical to that contained in the 1934 Act and, therefore, it will not be treated separately.

quoted in Tcherepnin v. Knight, 389 U. S. 332 (1967). In contending that their arrangement with Sicherman complies with this test, plaintiffs claim that:

> ". . . Sicherman made all the investment decisions with respect to plaintiffs' accounts. He managed, supervised and invested at his discretion in the commodities markets with their money. He fraudulently misrepresented to them that he would make a profit with their money and in fact he even sent to them false and fictitious confirmation slips of investments made on their behalf and statements of accounts falsely showing a 'profit,' thereby inducing them to invest even more money with him. Plaintiffs at no times relied upon their own judgments as to their investments, but relied solely on the efforts and discretion of a promoter, i.e., J. Samuel Sicherman, to bring about their expected return."

Defendants argue that plaintiffs were simply dealers in commodity futures contracts, jurisdiction over which is within the exclusive purview of the Commodities Exchange Act of 1936 and not the Securities Act of 1933 nor the Securities Exchange Act of 1934.[4]

Generally, contracts for the delivery of commodities in the future do not constitute "investment contracts" within the meaning of the term security in the Securities Exchange Act of 1934. Berman v. Orimex Trading, Inc., 291 F. Supp. 701 (S. D. N. Y. 1968) (cocoa futures contracts); Sinva, Inc. v. Merrill, Lynch, Pierce, Fenner & Smith, Inc., 253 F. Supp. 359 (S. D. N. Y. 1966) (sugar futures contracts). However, a special type of commodity investment account known as a discretionary commodities account can be an investment

4. The Commodities Exchange Act of 1936 contains no provision for extraterritorial service of process as do the two Securities Acts.

contract within the meaning of the term security whenever the agreement between the customer and the broker involves investments by the broker of his customers' funds in commodities futures contracts selected by the broker and the investor relies solely on his broker for his profits. Anderson v. Francis I. du Pont & Co., 291 F. Supp. 705 (D. Minn. 1968); Berman v. Orimex Trading, Inc., supra; Maheu v. Reynolds & Co., 292 F. Supp. 423 (S. D. N. Y. 1967).

Reviewing the allegations of the plaintiffs with respect to their arrangements with their broker Sicherman in the case at bar, I find that they are sufficient to establish that a discretionary commodities account existed between Sicherman and plaintiffs and, hence, an investment contract existed as that term is used in the Securities Exchange Act of 1934. For this reason, the service of process accomplished under Section 27 of the Securities Exchange Act of 1934 is valid and therefore jurisdiction in this Court is proper.[5]

Finally, although the central figure in the scheme which caused plaintiff to suffer their losses was J. Samuel Sicherman, the plaintiffs have alleged that the Board of Trade and the Exchange aided and abetted Sicherman in accomplishing his fraudulent scheme. At some future point in this proceeding the merits of these allegations will be tested, but for the purposes of the present motion, they must be assumed to be true. Accordingly, I conclude that plaintiffs' allegations that defendants aided and abetted Sicherman

5. Defendants' argument on Congressional intent is without merit. See Maheu v. Reynolds & Co., 282 F. Supp. 423 n.2 (S. D. N. Y. 1967). Moreover, its now accepted that defrauded commodities investors, as plaintiffs allege to be in the present action, have a federal civil remedy under the Commodities Exchange Act of 1936, notwithstanding the absence of specific mention of such a remedy in the Act. Goodman v. J. Hertz & Co., 265 F. Supp. 440 (N. D. Ill. 1967).

through their negligent failure to act when they had reasonable cause to suspect that their rules were being violated are sufficient to state a claim against the Board of Trade and the Exchange. Anderson v. Francis I. du Pont & Co., supra; Pettit v. American Stock Exchange, 217 F. Supp. 21 (S. D. N. Y. 1963).

II. Venue.

Plaintiffs invoke the venue provisions of Section 22 of the Securities Act of 1933 [6] and Section 27 of the Securities Exchange Act of 1934.[7] They contend that the Board of Trade and the Exchange (1) have transacted business in the Middle District of Pennsylvania, and (2) have committed violations of the Securities Laws in the Middle District. The Board of Trade asserts (1) that it is not an inhabitant of the Middle District, (2) that it is not found here, (3) that it does not transact business here, and (4) that it did not commit any Securities Law violations here. The Exchange makes the same points as the Board of Trade and also adds that it has no connection at all with this District. Affidavits have been submitted by all parties, although plaintiffs' affidavits were only in the nature of "answering" affidavits containing little or no affirmative facts.

The principal points to which the parties have addressed themselves in their briefs are whether the defendants have transacted business within the Middle District and whether violations of the Securities Laws have been committed here. On the first issue, the parties have relied upon the venue test as stated by the Delaware District Court in United Industrial Corp. v. Nuclear Corp. of America, 237 F. Supp. 971 (D. Del. 1964). The test requires ". . . that the activities constitute a substantial part

6. 15 U. S. C. § 77v(a), which contans a venue provision similar to the Securities Exchange Act of 1934. For this reason, venue under the Securities Act of 1933 will not be discussed separately.

7. 15 U. S. C. § 78aa. See note 6.

of a defendant's ordinary business, that they be continuous, and at least of some duration." 273 F. Supp. at 978. Although some cases hold that this test may not be the proper one for venue under the Securities Exchange Act, see Livingston v. Weis, Viosin, Cannon, Inc., 294 F. Supp. (D. N. J. 1968), we need not concern ourselves with the applicable test issue at the present time for I am satisfied that the course of action required by elementary principles of justice is to allow plaintiffs a reasonable time in which to establish with greater specificity that venue does exist in the Middle District. Ferraioli v. Cantor, 259 F. Supp. 842 (S. D. N. Y. 1966). All that is currently before the Court on transacting business are eleven contracts by defendants with the Middle District which plaintiffs contend are "arguably possible." There has been no resort to even the most rudimentary forms of discovery, i.e., written interrogatories, and, as a result, the record is just too uncertain to accommodate a reasoned judgment on the venue issue in a case of this importance.[8] Accordingly, the motion to dismiss for improper venue will be denied at the present time without prejudice for renewal on a later occasion. Plaintiffs will be allowed sixty days in which to undertake whatever discovery they believe necessary to establish that venue exists.[9]

/s/ WILLIAM J. NEALON,
United States District Judge.

December 31, 1970.

8. For the same reason, the issue as to whether defendants have committed any Securities Laws violations in the Middle District will not be decided.

9. See Fed. R. Civ. P. 26, 30, 31, 33, 34 and 36. Under these rules, for example, the plaintiffs may desire to explore Board of Trade business operations for years other than 1968, which was the only year discussed in an affidavit filed on behalf of the Board of Trade, or the plaintiffs may wish to further delve into the relationship between the Exchange and their member firms who maintain branch offices in the Middle District.

Order.

Now, December 31, 1970 in accordance with the Memorandum this day filed, it is Ordered that the motions of defendants to dismiss the complaint for invalid service of process be and the same are hereby denied. It is further Ordered that the motions of defendants to dismiss for improper venue be and the same are hereby denied without prejudice for subsequent renewal. Plaintiffs are granted sixty (60) days in which to undertake and complete discovery to establish that venue exists in the Middle District of Pennsylvania.

/s/ WILLIAM J. NEALON,
United States District Judge.

District Court Memorandum and Order.

Defendants have requested the court to reconsider its memorandum of December 30, 1970, in which the court denied defendants' motion to dismiss for lack of jurisdiction under the Securities Exchange Act of 1934 and for invalid service of process pursuant to § 27 of that Act. Defendants' motion was denied on the grounds that, in taking the allegations of plaintiffs' complaint as true, jurisdiction was proper in that the discretionary trading account in commodities futures that the plaintiffs had with J. Samuel Sicherman, trading as J. Samuel Sicherman & Co. (hereafter Sicherman), was an "investment contract" and hence a "security" within Section 2(1) of the Securities Act of 1933, 15 U. S. C. § 77b(1) and Section 3(a)(10) of the Securities Exchange Act of 1934, 15 U. S. C. § 78c (a)(10). In so ruling, the court relied on two decisions of the Southern District of New York, Berman v. Orimex Trading, Inc., 291 F. Supp. 701 (S. D. N. Y. 1968) and Maheu v. Reynolds & Co., 282 F. Supp. 423 (S. D. N. Y. 1967); *reargument denied* 282 F. Supp. 428 (1968), both apparently holding that a joint account in commodities futures may constitute a "security" even if there was no pooling arrangement or finding of a "common enterprise" as part of the agreement alleged to be a security. *See* Maheu v. Reynolds & Co., *supra* at 429.[1] *See also,* I Loss Securities Regulation 489, (2d Ed. 1961).

1. In its memorandum, the court also cited a decision from the District of Minnesota, Anderson v. Francis I. duPont & Co., 291 F. Supp. 705 (1968). However, unlike *Maheu, supra, Anderson* did not involve a separate discretionary trading agreement between numerous customers, but rather, in that court's words ". . . an investment pool . . . where individual contributions to the investment fund would enable him (defendant) to increase profits for all members of the fund." Anderson v. Francis I. duPont & Co., *supra* at 708.

Defendants now raise for the first time[2] their contention that the "commonality" aspect of the *Maheu & Berman* decisions conflicts with the Supreme Court's definition of a security as announced in S. E. C. v. W. J. Howey Co., 328 U. S. 293 (1946) and Tcherepnin v. Knight, 389 U. S. 332 (1967). In support of their contention, they request the court to reconsider its prior memorandum in light of the recent Seventh Circuit opinion in Milnarik v. M-S Commodities, Inc., 457 F. 2d 274 (7th Cir. 1972); cert. denied 41 U. S. L. W. 3188 (Oct. 10, 1972), which held, contrary to *Berman & Maheu*, that absent a finding of a common enterprise among investors, a discretionary account in commodities futures is not a security within the meaning of the federal securities laws. Thus, the above-cited cases represent two divergent lines of authority on this question. Inasmuch as I agree with defendants that the *Milnarik* court's requirement of finding a common enterprise is more consistent with the Supreme Court's definition of an "investment contract", a review of the facts and the analysis which that court used is in order.

In *Milnarik*, plaintiffs had opened a discretionary account with the defendant on the understanding that defendant would use the funds to trade in commodities futures for plaintiffs' benefit. After various trades on plaintiffs' account had resulted in losses, defendant demanded an additional sum to cover the losses. Plaintiffs refused and started an action in the Northern District of Illinois to rescind the agreement and recover their deposit plus interest, arguing that their commodities account was a "security"

2. Defendants' first motion to dismiss was based on their contention (1) that plaintiffs were simply dealers in commodities futures contracts and that jurisdiction over commodities futures is within the exclusive purview of the Commodities Exchange Act of 1936 and not the Securities laws, and (2) venue was not proper here in that the defendant Exchanges were not present here, nor did they transact any business here.

which should have been registered pursuant to Section 5 of the Securities Act of 1933. The District Court, after assuming the presence of a security, dismissed the complaint holding that the agreement resulted in a private rather than a public offering and, therefore, was not required to be registered. Milnarik v. M-S Commodities, Inc., 320 F. Supp. 1149 (N. D. Ill. 1970). Without reaching the question whether the offering was public or private, the Seventh Circuit Court of Appeals agreed that registration was not required, holding that the arrangement between plaintiffs and defendant did not constitute a security. In reaching their decision, the court reviewed both *Howey* and *Tcherepnin* and observed that ". . . [j]udicial analyses of the question whether particular investment contracts are 'securities' within the statutory definition have repeatedly stressed the significance of finding a common enterprise." Milnarik v. M-S Commodities, Inc., *supra* at 276. For example, in *Howey, supra,* the Supreme Court defined "security" as a

> "contract, transaction or scheme whereby a person invests his money in a *common enterprise* and is led to expect profits solely from the efforts of the promotor or a third party . . ." (Emphasis supplied.)

S. E. C. v. Howey, *supra* at 299. And, in *Tcherepnin* v. Knight, *supra,* a case arising under the 1934 Act, the Court identified the existence of a common enterprise as an important aspect of their analysis:

> "Of the several types of instruments designated as securities by § 3(a)(10) of the 1934 Act, the petitioners' shares most closely resemble investment contracts. 'The test [for an investment contract] is whether the scheme involves an investment of money in a common enterprise with profits to come solely

> from the efforts of others.' [S. E. C. v. W. J. Howey Co., 328 U. S. 293, 66 S. Ct. 1100, 90 L. Ed. 1244] at 301 [66 S. Ct. at 1104]. Petitioners are participants in a common enterprise—a money-lending operation dependent for its success upon the skill and efforts of the management of City Savings in making sound loans. Because Illinois law ties the payment of dividends on withdrawable capital shares to an apportionment of profits, the petitioners can expect a return on their investment only if City Savings shows a profit."

Tcherepnin v. Knight, *supra* at 338-339. In applying the *Howey* test in *Milnarik*, the court found the common enterprise element to be totally lacking:

> "We find the element of commonality absent here. Although the complaint does allege that Nelson entered into similar discretionary arrangements with other customers, the success or failure of those other contracts had no direct impact on the profitabiltiy of plaintiffs' contract. Nelson's various customers were represented by a common agent, but they were not joint participants in the same investment interprise."

Milnarik v. M-S Commodities, Inc., *supra,* at 276.

Further, the court quoted with approval the following excerpts from the district court's opinion describing the arrangement:

> "In essence, this contract creates an agency-for-hire rather than constituting the sale of a unit of a larger enterprise. No matter how many different persons Nelson became an agent for under similar or even identical discretionary contracts, his relationship with

> each would remain as that of agent and principal. Each contract creating this relationship is unitary in nature and each will be a success or failure without regard to the others. Some may show a profit, some a loss, but they are independent of each other. No matter how many discretionary trading accounts Nelson may have had with other principals, the 'security' 'issued' to the plaintiffs, their discretionary trading account, could not be offered to anyone else."
>
> "This characteristic of common enterprise is completely lacking in the present case. Even assuming that Nelson in fact solicited and collected money from numerous parties, no allegations are made that a common enterprise existed comprised of all people possessing discretionary account contracts with him. No claim is made that Nelson traded in a uniform manner for each of these accounts. Even if he had so uniformly traded, no pooling of funds for a common purpose is alleged. Nelson was apparently simply an agent for a number of separate and distinct principals, the plaintiffs being one such principal. The plaintiffs in no way can be viewed as having invested in a common enterprise with other suppliers of venture capital." Milnarik v. M-S Commodities, Inc., 320 F. Supp. *supra* at 1151-53.

This characterization of the agreement between the parties in *Milnarik* could equally be used to describe the arrangement between plaintiffs and Sicherman here. As in *Milnarik*, nothing in the instant complaint suggests the type common enterprise or pooling of funds for a common purpose required to convert the discretionary account plaintiffs had with Sicherman into a statutory security. The complaint simply alleges that plaintiff Keystone

Traders, Inc. engaged in "investment transactions managed and supervised by J. Samuel Sicherman & Co. as a 'discretionary commodity account' in the commodities market . . ." Plaintiffs' complaint, para. 1(d). Although, as in *Milnarik*, it is alleged that Sicherman had opened similar accounts with numerous customers, no claim is made that a joint enterprise existed comprised of a group of investors holding discretionary accounts with him. Indeed, the opposite appears to be the case. At various parts in the complaint, plaintiffs allege that Sicherman violated his duty to segregate and separately account for the funds in plaintiffs' account from other discretionary accounts. Plaintiffs' complaint, para. 3, 10. And in plaintiffs' answer to defendants' renewed motion to dismiss, plaintiffs claimed that Sicherman failed to segregate customer's funds and had illegally placed them into "one big pot". Thus, it is clear that plaintiffs did not enter into discretionary trading agreements with Sicherman with the understanding that their customers would share ratably in the profits. Without the presence of this element of the *Howey* test, plaintiffs' individual discretionary trading account with Sicherman cannot be considered as a security within the meaning of the Securities laws.

Plaintiffs seek to avoid this result in several ways. First, they seek to distinguish *Milnarik* by arguing that the issues in the two cases differ greatly, inasmuch as *Milnarik* dealt with whether the discretionary trading agreements had to be registered under Section 5 of the 1933 Act, whereas the instant action is based on the defendants' allegedly aiding and abetting Sicherman's fraudulent scheme in violation of the anti-fraud provisions of the 1934 Act. While the issues in the two cases do obviously differ, the ultimate question to be decided is the same. That question is whether discretionary trading

agreements in commodities futures fit the definition of an "investment contract" within the meannig of the Securities Acts. As noted earlier, the Supreme Court in S. E. C. v. *Howey, supra* defined the term "investment contract" for purposes of the registration requirements of the 1933 Act. Later, in Tcherepnin v. Knight, *supra*, a case arising under the 1934 Act, the Court pointed out that the definition of a security in § 2(1) of the 1933 Act is virtually identical to the 1934 Act definition. For this reason the Court applied the *Howey* definition and referred to decisions under the 1933 Act for aid in construing the 1934 Act. Thus, whether the question of what is a security arises under the 1933 Act or the 1934 Act, the test to be applied is identical. *See* Milnarik v. M-S Commodities, 320 F. Supp. *supra* at 1150; Anderson v. Francis I. duPont & Co., 291 F. Supp. *supra* at 707.

Next, plaintiffs contend that even assuming that a finding of a common enterprise is an essential element in the definition of a security, that this element is present here. They seek to find the existence of a common enterprise in the relationship between plaintiff Keystone Traders, described as an open-ended investment company [3] and

3. The purpose or purposes of the corporation are:

"To be and operate as an *open-end investment company;* to buy, sell, sell short, and in any other manner deal in commodities and commodity futures, including, but not limited to, soybeans, wheat, corn, rye, oats, lard, barley, flaxseed, cotton, cottonseed oil, crude soybean oil, soybean meal, wool tops, wool, burlap, sugar, coffee, cocoa, eggs, potatoes, hides, rubber, copper, zinc, lead, tin, platinum, silver and gold; to buy, sell, invest in, and in any manner deal in, stocks, bonds, mortgages, debentures, trust receipts, notes, and *other securities* and personal property of any sort, provided that the value of *investment securities* held by the coporation shall not equal or exceed forty percent (40%) of the corporation's total assets (exclusive of Government securities and cash items) on an unconsolidated basis; and to borrow money with or without security for any of the foregoing purposes." (Emphasis supplied)

its more than 200 stockholders. However, the agreement which plaintiffs have alleged to constitute an "investment contract" is the discretionary account which Keystone Traders, as an individual customer, opened with Sicherman and not the agreement between Keystone Traders and its stockholders. The nature of the relationship between Keystone Traders and its own stockholders is totally unrelated to the nature of the discretionary commodity agreements between each plaintiff and Sicherman. Consequently, plaintiffs' attempt to find the existence of a common enterprise in the agreement between Keystone Traders and its stockholders is without merit.

Finally, plaintiffs allege that, unlike *Milnarik* where defendant had segregated the funds of his customers, Sicherman's fraudulent commingling of his customers' funds when it was his duty to treat each discretionary account separately, provided the element of common enterprise lacking in *Milnarik*. What plaintiffs are arguing, in effect, is that an agreement which is not an "investment contract" can be transformed into an investment contract by the unilateral fraud of one party in violation of the original understanding. Whether an "investment contract" exists depends, like any other contract, upon the original intention of the parties to the arrangement. As noted earlier, plaintiffs' complaint makes it clear that it was not part of the original agreement for Sicherman to commingle the funds of his customers into "one big pot", or that each would share proportionately in the profits from the common fund. Hence, while Sicherman's handling of plaintiffs' account may amount to a fraud upon them and a breach of his contract with them, it does not amount to the creation of an "investment contract" within the meaning of the federal securities laws. Accordingly, since jurisdiction does not exist under either the Securities Act of 1933 or the

Securities Exchange Act of 1934, defendants' motion to dismiss must be granted and the complaint dismissed.

WILLIAM J. NEALON,
United States District Judge.

Dated: November 17, 1972

Order.

Now, this 17th day of November, 1972, upon reconsideration of the Court's prior Memorandum and Order of December 30, 1970, it is hereby ordered that the prior Order is vacated and defendants' motion to dismiss is granted.

WILLIAM J. NEALON,
United States District Judge.

District Court Memorandum and Order.

Plaintiffs have moved the court under Rule 60(b) to vacate its order of November 17, 1972[1] dismissing plaintiffs' complaint for lack of subject matter jurisdiction and request permission to amend their complaint by adding the following allegations to paragraph 20:

> "20(b) Keystone Traders, Inc., with approximately 200 stockholders is a Pennsylvania corporation organized as aforesaid in January, 1968 'as an open-end investment company,' as shown by the publicly published Articles of Incorporation filed with the Commonwealth of Pennsylvania.
>
> '3. The purpose or purposes of the corporation are: 'To be and operate as an *open-end investment company:* to buy, sell, sell short, and in any other manner deal in commodities and commodity futures, including, but not limited to, soybeans, wheat, corn, rye, oats, lard, barley, flaxseed, cotton, cottonseed oil, crude soybean oil, soybean meal, wool tops, wool, burlap, sugar, coffee, cocoa, eggs, potatoes, hides, rubber, copper, zinc, lead, tin, platinum, silver and gold; to buy, sell, invest in, and in any manner deal in, stocks, bonds, mortgages, debentures, trust receipts, notes, and *other securities* and personal property of any sort, provided that the value of *investment securities* held by the corporation shall not equal or exceed forty percent (40%) of the corporations's total assets (exclusive of Government securities and cash items) on an unconsolidated basis; and to borrow

1. Inasmuch as a motion under Rule 60(b) does not terminate the running of the tme for appeal, Muhs v. Acme-Hamilton Mfg. Co., 319 F. 2d 843 (3d Cir. 1963); 9 Moore's Federal Practice, ¶ 204.12 [1] n.9, and the time for appeal in this case expires December 18th, 1972, the court has moved with some urgency in this matter.

money with or without security for any of the foregoing purposes.' (Emphasis supplied.) Filed in the Dept. of State, Corporation Bureau, Commonwealth of Pa. to No. 3-1-65. 25 1348.

"21(a) Other Plaintiffs in this class action are stockholders of Commodity Fund, Inc., also 'an open-end investment company,' incorporated in Pennsylvania on August 18, 1959, as shown by its Charter from the Commonwealth of Pennsylvania.

'3. The purpose or purposes of the corporation are: 'To be and operate as an *open-end investment company:* to buy, sell, sell short, and in any other manner deal in commodities and commodity futures, including but not limited to, soybeans, wheat, corn, rye, oats, lard, barley, flaxseed, cotton, cottonseed oil, crude soybean oil, soybean meal, wool tops, wool, burlap, sugar, coffee, cocoa, eggs, potatoes, hides, rubber, copper zinc, lead, tin, platinum, silver and gold; to buy, sell, invest in, and in any manner deal in, stocks, bonds, mortgages, debentures, trust receipts, notes, and *other securities* and personal property of any sort, provided that the value of investment securities held by the corporation shall not equal or exceed forty percent (40%) of the corporation's total assets (exclusive of Government securities and cash items) on an unconsolidated basis; and to borrow money, with or without security, for any of the foregoing purposes.' (Emphasis supplied.) Filed in the Dept. of State, Corporation Bureau, Commonwealth of Pa. to No. .

"20(c) The paid-in capital of the Keystone Traders, Inc., amounted to approximately $500,000.00

with over 200 stockholders who invested their monies in this common enterprise upon sales of the capital stock thereof to them by J. S. Sicherman and/or his agents upon the understanding that the capital funds so raised would be invested by the corporation in trading in the Commodities markets and the profits from which were to be paid over to the respective stockholders, the said profits, if any, were to come solely from the investment skill of Sicherman.

"20(d) $315,000 in corporate funds were thereafter fraudulently transferred by J. S. Sicherman, Defendant, to J. S. Sicherman & Co., and this money was expended by Defendant Sicherman for fraudulent purposes to the detriment of the stockholders of, and the Keystone Traders, Inc."

Plaintiffs contend that these proposed amendments supply the commonality element which the court found to be lacking in its memorandum of November 17, 1972. They also claim that the judgment should be set aside because the court erred in not ruling on three issues allegedly raised in plaintiffs' complaint.[2] Defendants oppose any leave to

2. Ordinarily a motion under Rule 60(b) is not the proper manner in which to challenge a supposed legal error of the court or to assert errors that are correctible on appeal. 3 Barron & Holtzoff, Wright Ed. § 1323 n. 21. Yet this general rule may not have application where the time for appeal has not yet expired. Under these circumstances, the court should allow a motion to vacate in order to correct an erroneous judgment. However, inasmuch as none of the three issues which plaintiffs claim the court should have ruled on were necessary to decide, no error has been made. The first two issues dealt with alleged causes of action for money damages which plaintiffs claim they had against defendants under the Commodities Exchange Act. 7 U. S. C. § 1 et seq. *Cf.* Goodman v. H. Hentz & Co., 265 F. Supp. 440 (N. D. Ill. 1967). Since there is no provision for extraterritorial service of process under the Exchange Act and hence this court could not assert jurisdiction over these defendants, a ruling on whether plaintiffs have stated a cause of action under

amend the complaint contending that (1) the reasons asserted by plaintiffs for vacating the court's order are not among those contemplated by Rule 60(b) and (2) even if allowed to amend, plaintiffs have not cured the deficiencies present in the original complaint.

While it is true that a party seeking to amend a complaint after judgment has been entered will be successful only if he first demonstrates that the judgment should be set aside for one of the six reasons specified in Rule 60(b), Swam v. United States, 327 F. 2d 431 (7th Cir.), *Cert. denied* 379 U. S. 852 (1964); 6 Wright and Miller, Federal Practice and Procedure, Sec. 1489, and that the reasons advanced by plaintiffs here are arguably not within the scope of Rule 60(b), a party may, independently of Rule 60(b), amend defective allegations of jurisdiction under 28 U. S. C. Sec. 1653[3] even after judgment has been entered. Eklund v. Mora, 410 F. 2d 731 (5th Cir. 1969).

Section 1653 provides that "[d]efective allegations of jurisdiction may be amended, upon terms, in the trial or appellate courts." An application under Sec. 1653 is addressed to the sound discretion of the court and is to be construed liberally to allow amendment if it is possible to determine from the record that jurisdiction does exist. John Birch Society v. NBC, 377 F. 2d 194 (2d Cir. 1967); Moore v. Coats Co., 270 F. 2d 410, 412 (3rd Cir. 1959). However, where as here, the proposed amendment would not cure the defect in the original pleading, the motion to

---

2. (Cont'd.)
the Commodities Exchange Act would serve no legal purpose. Similarly, the third issue, which dealt with plaintiffs' legal theory under the Securities Exchange Act, was also not necessary to decide in view of the court's disposition of the jurisdictional issue.

3. This section permits amendment of all jurisdictional allegations rather than merely allegations of diversity of citizenship as provided by the former section. Revisers Notes of 1948 Code.

amend should be denied. Cox v. Livingston, 407 F. 2d 392 (2d Cir. 1969); John Birch Society v. NBC, supra.

Plaintiffs argue that the amended complaint would show that the element of a common enterprise exists in the relationship between Keystone Traders, Inc., and its more than 200 stockholders. They claim that Sicherman and/or his agents sold stock of Keystone Traders, Inc. to the shareholders with the understanding that *the corporation* would in turn invest the funds so raised in the commodities market, thus establishing a common enterprise. This may well be true, but as pointed out in the prior memorandum, this is not the "investment contract" upon which plaintiffs have relied to establish jurisdiction. Plaintiffs' original complaint, which would still be intact except for the proposed amendment to paragraph 20, clearly points out that the agreements which plaintiffs have alleged constitute an "investment contract" are the separate discretionary accounts which Keystone Traders, as well as other customers, had with J. Samuel Sicherman & Co. and not the agreement between Keystone Traders and its stockholders. The theory upon which plaintiffs have based their cause of action is that a class of investors and customers of Sicherman, of whom Keystone Traders was one, opened discretionary accounts with Sicherman on the understanding that Sicherman would use the funds to trade in commodities futures. However, instead of investing his customers' funds, Sicherman fraudulently converted these funds to his own use. It is J. S. Sicherman & Co. that is charged, as a defendant, with such fraud and the co-defendants are sought to be held liable under the Act on the theory that they aided and abetted Sicherman in the fraudulent scheme. It was on the basis of these discretionary accounts which the class of plaintiffs had with Sicherman that plaintiffs asserted jurisdiction under the federal securities laws. The court has

already ruled that these separate discretionary accounts did not constitute an investment contract within the meaning of the securities laws. To allow the amendment sought here would not change the result. Consequently, plaintiffs' motion to vacate the court's order of November 17, 1972, will be denied.

WILLIAM J. NEALON,
United States District Judge.

Dated: December 15, 1972

Filed: Same Date.

Order.

Now, this 15th day of December, 1972, in accordance with the memorandum filed this day, it is ordered that plaintiffs' motion to vacate the court's order of November 17, 1972, and their motion to amend their complaint are hereby denied.

WILLIAM J. NEALON,
United States District Judge.

SUPREME COURT, U. S.

Supreme Court, U. S.
FILED
APR 19 1974
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No. 73-1409

In the
Supreme Court of the United States
OCTOBER TERM, 1973

JOHN J. WASNOWIC and KEYSTONE TRADERS, INC.,

Petitioners,

vs.

CHICAGO BOARD OF TRADE and CHICAGO MERCANTILE EXCHANGE,

Respondents.

BRIEF OF RESPONDENTS CHICAGO BOARD OF TRADE AND CHICAGO MERCANTILE EXCHANGE IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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IN THE

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OCTOBER TERM, 1973

No. 73-1409

JOHN J. WASNOWIC and KEYSTONE TRADERS, INC.,

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BRIEF OF RESPONDENTS CHICAGO BOARD OF TRADE AND CHICAGO MERCANTILE EXCHANGE IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

Respondents Chicago Board of Trade and Chicago Mercantile Exchange (hereinafter referred to as the "Exchanges"), submit that the petition for writ of certiorari is without merit and should be denied.

QUESTION PRESENTED

This case does not raise the "Questions Presented" framed in the petition (p. 5). The sole question presented is whether the lower courts committed reversible error in ruling that the following allegations do not state a

claim *against the Exchanges* under the federal securities laws

(1) petitioners, by separate and independent action, gave authority to J.S. Sicherman, a commodity broker, to buy and sell commodity futures contracts in his discretion for their respective accounts;[1]

(2) instead of using that authority Sicherman converted petitioners' funds to other uses and concealed his activity by issuing false reports showing fictitious and pretended trades; and

(3) the two Exchanges, where Sicherman was a member, failed to discover his wrongdoing.

Petitioners brought this action in their home district knowing that the Exchanges could not be served with process there and that long-arm service was not authorized by the Commodity Exchange Act, their principal basis for suit. Instead, they sought extraterritorial service under §27 of the Securities Exchange Act on the theory that the same allegations used to show a violation of the Commodity Exchange Act also stated a claim against the Exchanges under the Securities Act of 1933 and the Securities Exchange Act of 1934. We submit that the District Court and the Third Circuit were correct in ruling that the allegations of the complaint do not involve a violation of the federal securities laws *by the Exchanges*.

No "subsidiary question" exists concerning petitioners' right to amend their complaint (p. 5). Those amendments

[1] Had the complaint been formally amended to recite that petitioner Keystone Traders, Inc. was an investment company, this allegation would remain accurately stated.

sought in various ways to show a new and different fraud, pre-dating the opening of commodity accounts, in which Sicherman sold shares in Keystone Traders and another corporate entity to the public. The courts below reviewed the complaint as if it had been amended (A23-24) and concluded that, whatever might be the relationship between investors in these separate companies and Sicherman, these allegations concerned activities which were too remote from the operations and duties of the Exchanges to establish jurisdiction under the federal securities laws.

STATEMENT OF THE CASE

Petitioners' Statement (pp. 6-9) contains a number of inaccuracies. For example, no allegation in the complaint supports petitioners' statement that "all investment decisions were made solely by Sicherman, as agreed by the parties" (p. 6). Rather than burden the Court with a separate Statement, we have set forth the necessary factual background for each issue discussed.

REASONS FOR DENYING THE WRIT

Petitioners' arguments for granting a writ are without merit. The issue that they consider to be critical—whether discretionary commodity accounts are "investment contracts"—was recently presented in *Milnarik* v. *M-S Commodities, Inc.*, 457 F.2d 274 (7th Cir. 1972), which this Court declined to review. 409 U.S. 887 (1972). Nothing has since happened to warrant a different result. Moreover, even were that issue resolved in petitioners' favor, the complaint would not state a claim *against the Exchanges* under the federal securities laws unless the Third Circuit suddenly reversed its position that mere failure of the Exchanges to discover Sicherman's wrongdoing does not constitute "aiding and abetting" the fraud.

The rulings below neither conflict with the prior decisions of the Supreme Court nor with the decision of any other Circuit. Although a district court has chosen to reject the decisions of the Seventh Circuit in *Milnarik* and the Third Circuit in this case, that is not sufficient reason to bypass the normal appellate procedures for the reconciliation of trial court decisions.

I. The Rulings Below Are Entirely Consistent With the Supreme Court's Definition of an "Investment Contract."

Petitioners endeavor to show a conflict between the decisions below and this Court's definition of an "investment contract." To create the appearance of conflict, petitioners mischaracterize the decisions below as stating that an investment contract does not exist unless there is a pooling or commingling of investors' funds (pp. 10, 12). A fair reading of the District Court's decision shows, instead, that it properly insisted that "commonality" must

exist, and merely cited the pooling or commingling of funds as evidence of a "joint enterprise" (A14-15). The lower courts found that the petitioners' discretionary commodity accounts were not a "common enterprise" because they were wholly independent of each other in their ownership, in their operation, and in their success or failure (A13-15).

The decisions below applied the concept of "common enterprise" embodied in this Court's definition of an "investment contract" under the federal securities laws. Every Supreme Court decision has involved a scheme where either the costs of operation or the risks of ownership of a profit-seeking venture have been spread by the offering or sale of interests to investors. That is the clear meaning of *SEC* v. *W. J. Howey Co.*, 328 U.S. 293, 298-99 (1946):

> In other words, an investment contract for purposes of the Securities Act means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party, it being immaterial whether the shares in the enterprise are evidenced by formal certificates or by nominal interests in the physical assets employed in the enterprise . . . .

Petitioners, however, misstate the facts and legal principles of this Court's prior holdings trying to create the appearance of conflict. Especially misleading is their assertion that *Howey* merely concerned the sale of individual parcels of land to separate and unrelated buyers (p. 12-13). On the contrary, the "common enterprise" in *Howey* was a citrus grove in which over 40 widely-scattered investors, by contributing operating capital, received documents called "warranty deeds" entitling them to share in

the profits from the pooled sale of the grove's fruit. This Court expressly noted that the warranty deeds were simply "a convenient method of determining the investors' allocable shares of the profits" and "the resulting transfer of rights in land is purely incidental." The "individual plots could only be developed as component parts of a larger area." 328 U.S. at 300.

In *SEC* v. *C. M. Joiner Leasing Corp.*, 320 U.S. 344 (1943), the common enterprise was an oil exploration venture which roughly 50 persons helped to finance by purchase of "leaseholds" whose value depended upon the success of the venture. Most recently, in *Tcherepnin* v. *Knight*, 389 U.S. 332 (1967), the requisite common enterprise was a lending institution to which over 5,000 persons contributed capital and received withdrawable capital shares paying dividends on the institution's net profits.

A discretionary commodity account has none of the characteristics of a common enterprise, as was explained in *Milnarik* v. *M-S Commodities, Inc.*, 457 F.2d 274, 278 (7th Cir. 1972):

> This characteristic of common enterprise is completely lacking in the present case. Even assuming that Nelson in fact solicited and collected money from numerous parties, no allegations are made that a common enterprise existed comprised of all people possessing discretionary account contracts with him. No claim is made that Nelson traded in a uniform manner for each of these accounts. Even if he had so uniformly traded, no pooling of funds for a common purpose is alleged. Nelson was apparently simply an agent for a number of separate and distinct principals, the plaintiffs being one such principal. The plaintiffs in no way can be viewed as having invested in a common enterprise with other suppliers of venture capital. Without such common investment, the property sale cases are not analogous.

Rather, a discretionary commodity account is wholly independent and unrelated in its ownership or its prospects for success to any other account:

> We find the element of commonality absent here. Although the complaint does allege that Nelson entered into similar discretionary arrangements with other customers, the success or failure of those other contracts had no direct impact on the profitability of plaintiffs' contract. Nelson's various customers were represented by a common agent, but they were not joint participants in the same investment enterprise.
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> In essence, this contract creates an agency-for-hire rather than constituting the sale of a unit of a larger enterprise. No matter how many different persons Nelson became an agent for under similar or even identical discretionary contracts, his relationship with each would remain as that of agent and principal. Each contract creating this relationship is unitary in nature and each will be a success or failure without regard to the others. Some may show a profit, some a loss, but they are independent of each other. (457 F.2d at 276-77).

The District Court in the present case found that the discretionary commodity accounts of petitioners' were the same as in *Milnarik* (A14), and ruled that they did not constitute "investment contracts."

Petitioners argue, without support, that a "common enterprise" can exist where the venture is wholly owned by a single person, if the efforts of third parties are important to that person's profit (p. 15). Every case cited, however, involved schemes with more than one investor (the term "investor" implies participation with others) and in which the courts pierced the promoter's efforts to create the illusion of separate transactions with individual purchasers. The forty separate "warranty

deeds" in *Howey* were found to be a subterfuge because the parcels of land "purchased" were too small for economical farming, entry to the land was forbidden, and the purchaser had no claim to specific fruit but shared in the income from a pooled sale of all fruit. (328 U.S. at 295-96). At least nine investors were involved in *Blackwell* v. *Bentsen*, 203 F.2d 690 (5th Cir. 1953), a program similar to *Howey*, which the promoters themselves described as "for the joint benefit of all investors." Thousands of persons were involved in *SEC* v. *Glenn W. Turner Enterprises, Inc.*, 474 F.2d 476 (9th Cir. 1973), where Turner disguised the sale of interests in his business by offering "self-improvement courses" entitling the purchasers to share thereafter in the income Turner received from subsequent sales of the "courses."[2] Accordingly, no decisions are cited which equate a "common enterprise" with a venture wholly owned by a single investor, such as the separate commodity accounts owned exclusively by each petitioner.

II. No Conflict Exists Between the Circuits.

There is no conflict between the Circuits on the issue whether a discretionary commodity account is an "investment contract" or other security under the Securities Act of 1933 or the Securities Exchange Act of 1934. Only the Seventh and Third Circuits have adjudicated the question and both have ruled that such accounts are not securities. *Milnarik* v. *M-S Commodities, Inc.*, 457 F.2d 274 (7th Cir.) *cert. denied*, 409 U.S. 887 (1972); and

[2] A district court in the Ninth Circuit has held *Turner* inapplicable to discretionary commodity accounts because the "widespread promotional scheme under which investors were induced to purchase" interests in Turner's enterprise was not remotely similar to "an ordinary brokerage agreement." (*Stuckey* v. *duPont Glore Forgan, Inc.*, 59 F.R.D. 129, 131 (N.D. Cal. 1973).

Wasnowic v. *Chicago Board of Trade* (3d Cir., December 21, 1973), *aff'g*, 352 F. Supp. 1066 (M.D. Pa. 1972).

Two cases are cited by petitioners to demonstrate a "conflict" but neither has that effect. One decision is *Commercial Iron & Metal Co.* v. *Bache & Co., Inc.*, 478 F.2d 39 (10th Cir. 1972). Far from ruling that discretionary commodity accounts are securities, the Tenth Circuit in *Commercial Iron* declined to pass upon the issue:

> We must emphasize that we are in no manner implying that Commercial's agreement with Bache constituted an investment contract. At this stage of the proceeding we do not have the evidence before us to make such a determination. Our decision only states that appellant's complaint and affidavit allege issues of material fact which cannot be resolved without further proceedings. (478 F.2d at 43).

Moreover, the account in *Commercial* did not involve commodity futures contracts, but rather instruments created by Bache itself and offered to customers as an investment in electrolytic copper owned by Bache.

The other case cited by petitioners is the Eighth Circuit's opinion in *Booth* v. *Peavey Company Commodity Services*, 430 F.2d 132 (8th Cir. 1970). The issue was whether the plaintiff's account had been "churned." A directed verdict for the broker was granted on substantial evidence that the account was not truly "discretionary." The Eighth Circuit noted that the broker and customer talked by telephone eighty-one times on forty-five days when the trading was occurring (430 F.2d at 134), and that the customer described trades made without such communication to be "unauthorized." (430 F.2d at 135). What petitioners focus upon, instead, is *dictum* by the Eighth Circuit compiling earlier district court decisions and stating that commodity churning cases might be

brought under either the Commodity Exchange Act or the federal securities laws. The Eighth Circuit admitted that the comment was gratuitous since "the point was not argued by the parties" (430 F.2d at 133). Moreover, its statement predated the more thorough analysis made by the Seventh Circuit in *Milnarik* and the later decisions following *Milnarik*.[2]

Consequently, neither *Booth* nor *Commercial Iron* support petitioners' contention that a "conflict" exists with the decisions of the Seventh and Third Circuits.

The district court in *Marshall* v. *Lamson Bros. & Co.*, 368 F.Supp. 486 (S.D. Iowa 1974) has rejected the reasoning in *Milnarik* and the present case, but that is no basis for granting a writ of certiorari. The respective Courts of Appeals should first be given the opportunity to resolve such conflicts, before review by the Supreme Court.

III. The Lower Courts Properly Held That Amendment of the Complaint Would Not Provide Jurisdiction Over the Exchanges.

Failing to secure long-arm jurisdiction over the Exchanges pursuant to the federal securities laws with respect to Sicherman's conversion of funds from discretionary commodity accounts, petitioners sought to amend their complaint to charge Sicherman with fraud in the formation of certain corporations, including petitioner Keystone Traders, Inc. The nature of the fraud, defined in subsequent attempts by petitioners to amend, involved misrepresentations by Sicherman as to the character, worth and purpose of the corporations whose shares he was selling. (A20-25). The District Court ruled upon the complaint as if amended, holding that the nature of the

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[2] See *Stuckey* v. *duPont Glore Forgan, Inc.*, 59 F.R.D. 129 (N.D. Calif. 1973).

relationship between these corporations and their stockholders was "totally unrelated" to the alleged existence of a "security" which would confer jurisdiction over the Exchanges (A16-17). When petitioners renewed their motion to amend the complaint, the District Court pointed out again that the relationship of shareholders to the corporations that invested funds in discretionary trading accounts was not the "investment contract" on which petitioners (necessarily) relied to establish jurisdiction *over the Exchanges*. There is no basis to disturb the determination that amendment of the complaint would not cure its deficiencies.

IV. The Court of Appeals Properly Affirmed Dismissal of the Complaint Because It Fails To State a Claim Against the Exchange For "Aiding And Abetting" Sicherman's Alleged Violations of the Federal Securities Laws.

The Exchanges moved the District Court to dismiss the complaint because petitioners charged only that the Exchanges negligently failed to supervise Sicherman's activities or detect his fraud, and these allegations did not support the conclusion that the Exchanges aided and abetted Sicherman's violations. The District Court, however, accepted petitioners' use of the phrase "aiding and abetting" as sufficient to state a claim against the Exchanges. On appeal to the Third Circuit, the Exchanges contended that the dismissal should be affirmed because the facts alleged in the complaint were not sufficient to state a claim against them for aiding and abetting.[4]

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[4] On a motion to dismiss, the sufficiency of the complaint must be tested against the well-pleaded facts, not conclusions of the pleader. *Pacific States Box & Basket Co.* v. *White*, 296 U.S. 176, 185 (1935); *Newport News Shipbuilding & Dry Dock Co.* v. *Shauffler*, 303 U.S. 54 (1938).

A. The Insufficiency of the Complaint Is a Proper Basis For Denying Certiorari.

This Court has repeatedly held that "a successful party in the District Court may sustain its judgment on any ground that finds support in the record." *Jaffke* v. *Dunham*, 352 U.S. 280, 281 (1957); *United States* v. *American Railway Express Co.*, 265 U.S. 425, 435 (1924); *Jamesbury Corp.* v. *Worcester Valve Co.*, 453 F.2d 205 (1st Cir. 1971). Since the complaint contains no factual allegations that the Exchanges knowingly assisted in Sicherman's alleged fraud, it did not state a claim under the legal principles announced by this Court and the Third Circuit. Accordingly, there is no reason to disturb the decisions of the lower courts, regardless of the holding that discretionary commodity accounts are not investment contracts.

B. The Complaint Was Deficient Because It Contained No Allegation That the Exchanges Knowingly Participated in Sicherman's Alleged Fraudulent Conduct.

The Third Circuit has recently declared that a defendant cannot be held to answer as an aider and abettor of fraudulent conduct absent some allegation of *knowing participation* on its part. In *Landy* v. *Federal Deposit Insurance Corp.*, 486 F.2d 139 (3d Cir. 1973), *cert. pending*, No. 73-819, the Third Circuit defined the elements that must be alleged and proven to constitute "aiding and abetting" in a securities fraud case as follows:

> Three elements are thus required for liability: (1) that an independent wrong exist; (2) that the aider or abettor know of that wrong's existence; and (3) that substantial assistance be given in effecting that wrong. 486 F.2d at 162-63.

Given this precedent, the Third Circuit's affirmance should be viewed as premised, in part, on a determination that

the complaint should be dismissed for failure to state a claim.

Judged against the well established standards for what constitutes aiding and abetting, the complaint was plainly insufficient. As this Court stressed in *Nye & Nissen* v. *United States*, 336 U.S. 613, 619 (1949):

> In order to aid and abet another to commit a crime it is necessary that a defendant "in some sort associate himself with the venture, that he participate in it as in something that he wishes to bring about, that he seek by his action to make it succeed."

These prerequisities to liability for aiding and abetting have been consistently applied to charges of fraud under the federal securities laws. *E.g.*, *Brennan* v. *Midwestern United Life Insurance Co.*, 259 F.Supp. 673, 680 (N.D. Ind. 1966), *aff'd*, 417 F.2d 147, 153-154 (7th Cir. 1969); *Hochfelder* v. *Midwest Stock Exchange*, 350 F.Supp. 1122 (N.D. Ill. 1972); *Wessel* v. *Buhler*, 437 F.2d 279, 283 (9th Cir. 1971). The Ninth Circuit recently held in *Strong* v. *France*, 474 F.2d 747, 752 (1973), that inaction does not support a claim of "aiding and abetting" unless it is designed to conceal a fraud known to the inactive party.

Accordingly, even were the complaint found to state a claim of "securities" fraud against Sicherman, it would remain insufficient to charge the Exchanges with having "aided or abetted" the violation by their mere failure to discover his fraud. The decisions below should be sustained on this ground.

V. The Theory Underlying Petitioners' Complaint Would Impair Public Policy by Confusing the Separate Regulatory Schemes Established by Congress For Securities and Commodities.

Any claim against the Exchanges for Sicherman's misappropriation of funds arises under the Commodity Ex-

change Act. It is apparent, though, that petitioners have invoked the federal securities laws in an effort to maintain their action in the Middle District of Pennsylvania where long-arm service on the Exchanges was required. Dismissal of the complaint merely confirmed that petitioners elected to sue the Exchanges in the wrong forum and prevented blurring of the sharp differentiation made by Congress between regulation of futures trading and regulation of securities transactions.

The Commodity Exchange Act (7 U.S.C. §§1 et seq.) vests regulation of commodity brokers and the Exchanges, as contract markets, in the Secretary of Agriculture ("Secretary") and an independent agency, the Commodity Exchange Commission ("Commission"). Pursuant to the Commodity Exchange Act, the Secretary has promulgated extensive rules and regulations (see 17 C.F.R. §§1 et seq.) and has organized the Commodity Exchange Authority, to supervise daily activities of licensed futures commission merchants and contract markets.

On the other hand, the Securities Act of 1933 and the Securities Exchange Act of 1934 were adopted to govern securities transactions, broker-dealers in securities and stock exchanges. The Securities and Exchange Commission has no status or role under the Commodity Exchange Act. It does not purport to involve itself in the supervision of commodity futures trading or in the regulation of futures commission merchants and contract market.[5]

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[5] Indeed, *Milnarik's* ruling that discretionary commodity accounts are not "investment contracts" has been cited by the Securities and Exchange Commission under its "no action letter" procedure. *CBWL-Hayden Stone, Inc.*, 1972-73 CCH Fed. Sec. L. Rep., ¶79,262 (Feb. 2, 1973).

Petitioners claim to have a private right of action under the Commodity Exchange Act against Sicherman for his conversion of customer funds and against the Exchanges for the alleged violation of their self-regulatory duty to prevent Sicherman's misconduct. See *Goodman* v. *H. Hentz & Co.*, 265 F. Supp. 440, 446-447 (N.D. Ill. 1967). The absence of a claim under the securities laws affects only the forum in which plaintiffs must pursue their remedies.

CONCLUSION

For the foregoing reasons, we submit that the petition should be denied.

Respectfully submitted,

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